



# **CASH FLOW – WHAT’S THE BIG DEAL?**


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# Cash Flow

- Most of us dentists feel that we have a good understanding of what cash flow and profitability is.
- This opinion is not always justified.
- In this session we will analyze the true facts of cash flow, profitability, and how they impact your ongoing practice and how they will affect your ultimate transition.

# CASH FLOW FOR OWNERS

- CASH FLOW – just what is it?
  - The sum of all *qualified* income and expenses.
  - It can be positive or negative.
  - There are several components.
  - It's especially important to understand how the actual *profit* component is derived – it's probably not what you think.

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- Cash flow is the net sum of two components
    - Qualified Practice Income
      - Exclusive of Other Income, Interest Earned, Refunds, Commissions from other practices, and the like.
      - This consists solely of revenue for this singular practice from patient payments for treatment provided.



- Qualified Practice Expenses

- Exclusive of elective expenses, depreciation, amortization, interest, taxes, great vacations (CE), auto expense, great dinners (business entertainment) and the like.
- *Practice expenses do include the cost of the owner's labor*

- I impute the owner's salary at 35% of the revenues for the owner's exclusive collections.
- The owner salary is treated as any other practice expense.
- Your practice profit is the revenue remaining after all expenses, *including the owner's salary*.
- A typical well-managed practice will have a cash flow of 52% of the owner's exclusive collections – 35% for the owner's salary and 17% of practice profit.

# CASH FLOW FOR BUYERS

- For new purchasers, I consider the debt service of principal and interest a personal expense and not deducted as a practice expense.
- Interest expense is tax deductible while the principal part of a loan payment is not tax deductible.
- Depreciation and amortization, while not cash expenses, are deductible expenses that approximates principal payments

# CASH FLOW FOR BUYERS

- Cash flow is measured and evaluated by two statistics –dollars and percentages.
- Practices must yield enough dollar cash flow to support an owner's living expenses.
- The owner must have a successful percentage net income to avoid burn-out.
- The minimum percentage for a first year buyer after all expenses and debt service should be no less than 30%.



- So what does all of this mean?
- If you are a practice owner, which means one day you will be a seller...
  - Cash flow will determine your practice value and marketability (desirability) at the time of a sale.
  - Cash flow success will maximize the income you receive from your practice from now until time of sale.

- What determines cash flow?
  - Cash flow can be increased by increasing the revenues. Additional expenses are relatively small.
  - Cash flow can be increased by reducing expenses.
  - Implementing both of these operatives provides the best cash flow results.



- Increasing revenues

- It can be challenge for owners who are in their slow-down phase and who are not motivated to take on more production and more services.
- Management consultants are often able to increase revenues without increasing excessive effort.
- Higher revenues definitely result in an increase in practice value from the Market Approach to value.


- Lowering expenses
  - This requires a careful analysis of overhead expenses and comparing actual experience to industry standards.
  - Salaries are frequently higher percentage-wise in older practices. Benchmark for salaries and all associated taxes and benefits is 28% of gross.
  - Too often salaries are raised each year, even if income decreases.




- Lowering expenses

- Another runaway expense is clinical supplies.
- Supply expense needs to be monitored and should be no more than 7% of gross revenues.
- Lab expenses will vary by the amount of prosthetic treatment done, but unless the practice is a prosthetic specialty, 11% is a maximum value for this line item.
- Owner salary of 35% of owner's production should be included as an expense.

- Elective and Creative expenses
  - The difference
  - Almost every practice has deductions that are not actually expenses.
  - Trained valuers can identify and deduct those expenses.
  - Problems arise when owners overdo these expenses or put them in areas that are difficult to justify adjusting.
  - When adding fat, don't put it in the heart.

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- Creative expenses
    - Here's where to hide creative expenses
      - Continuing education
      - Travel
      - Automobile expense
      - Equipment leases if back to the owner or trust
      - Non-working family salaries
      - Rental for owned office

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- It is difficult to adjust out personal expenses from
    - Laboratory
    - Clinical supplies
    - Office supplies
    - Marketing



- Cash Flow and Practice Valuations
  - Lenders examine practice cash flow closely.
  - Lenders need to know that purchasers can pay expenses, make a successful net income and service their debt from the practice revenues.
  - Lenders will decline loans to practices with substandard cash flow.
  - Price adjustment can never resolve a substandard practice cash flow.

- Benefits of a success cash flow for owners
  - Practice will be most desirable in the marketplace.
  - Practice will be able to command the highest price in the marketplace.
  - Practice will be totally financeable by lenders.
  - Practice will yield the highest net income from now until closing of sale.

- Benefits of successful cash flow for purchasers
  - Yields highest net income
  - Most secure, lowest risk opportunity to be had.
  - Most likely to obtain financing and getting the best rates and terms.
  - Profit is available to afford technology upgrades.
  - Provides greatest security in affording the purchase of a building when available.



- The Issue of Price

- Typically purchasers focus on practice price and don't understand practice cash flow.
- This can result in buying a cheap practice and receiving substandard cash flow.
- This leads to a high failure risk.




- The Issue of Price

- Overpaying for a practice with excellent cash flow can result in a very successful cash flow for a buyer.
- Low-priced practices with poor cash flow can result in unrecoverable financial outcomes.
- It is important to remember that price is what the seller leaves the closing table with.
- Cash flow is what the purchaser leaves the closing table with.



- Risk versus Exposure

- The higher the practice price, the greater the exposure – there's just more money at stake.
- Higher risk is a characteristic of low cash flow, not high prices.


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- Risk occurs with weak practice cash flow.
  - Large practices have a large margin above the break-even point and can survive a loss in income and still provide a quite successful cash flow.
  - Practices with small revenues can fail with even small income losses.
  - Practices with strong financial “bones” are never over-priced and are the safest of opportunities.



- Summary

- The better the practice cash flow, the better the seller advantages are
  - Net income
  - Price
  - Marketability



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- The better the practice cash flow, the better the purchaser advantages are
    - Higher net income
    - Easier to obtain purchase financing
    - Higher practice equity value
    - Higher practice liquidity

# TEN TRANSITION AND MANAGEMENT MYTHS


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What is a myth?

And why are we talking about them?

- MYTH - a collectively held belief that has no basis in fact.
  - Problems arise when people act on myths and the myths are not true and the results are not happy.
  - Dental practice Transition and Management are fraught with many myths.
  - Let's learn a few.

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- What percent of the practice patients are lost when someone buys a practice?

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- How do you know?



You lose 20% of your patients  
when you buy a practice.

Really?

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- What is the average overhead percentage in an average practice?





Overhead is around 60% -70% in most practices.

But while it's true, it is misleading.




What percent of gross does a practice sell for?


What percent of practices sell for that percent?



Practices sell for around 64% of  
their gross revenues.  
Sometimes.




Buyers don't have money, so I'll  
have to finance my practice sale  
myself.



My banker knows me and my practice and will lend the money to a buyer.



That's funny.



Money is available, but only if  
you know who to go to and  
how to ask for it.




I need the seller to stay and help  
me with the transition.

Or


I need to stay on and help the  
seller with the transition.




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- Is there anything special about making a legal contract for selling my practice?
  - My uncle (cousin, wife, neighbor, nephew, family attorney, etc.) is an attorney and can take care of the legal matters.



They can, but usually not very well. Not very well at all.



I don't need a broker. My associate  
will be buying my practice.



These can be some of the most difficult sales requiring the most finesse.



This practice is very expensive. It's way too risky.

How could I ever afford to pay for this practice?



The truth is, the cheaper the practice, the riskier the purchase.

Why not let someone else pay the payments for you to have a really good practice?

The hygienist will be happy to.



I'm already buying an expensive practice.

It's impossible to buy the building too.



Many times a building mortgage payment is less than what rent would be.

Mortgage payments don't increase each year

Mortgage payments also end and they have something to show for it.






Some lagniappe.

My landlord is a good guy.



Ha Ha Ha Ha Ha

Landlords are the biggest obstacles to practice sales of any party I've encountered.



Before we talk business, I just need to have some dinners with the buyer and our spouses to see how we get along.



I try to disqualify prospects  
first.



There are some popular myths.

Try to avoid these and discover  
new ones.

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